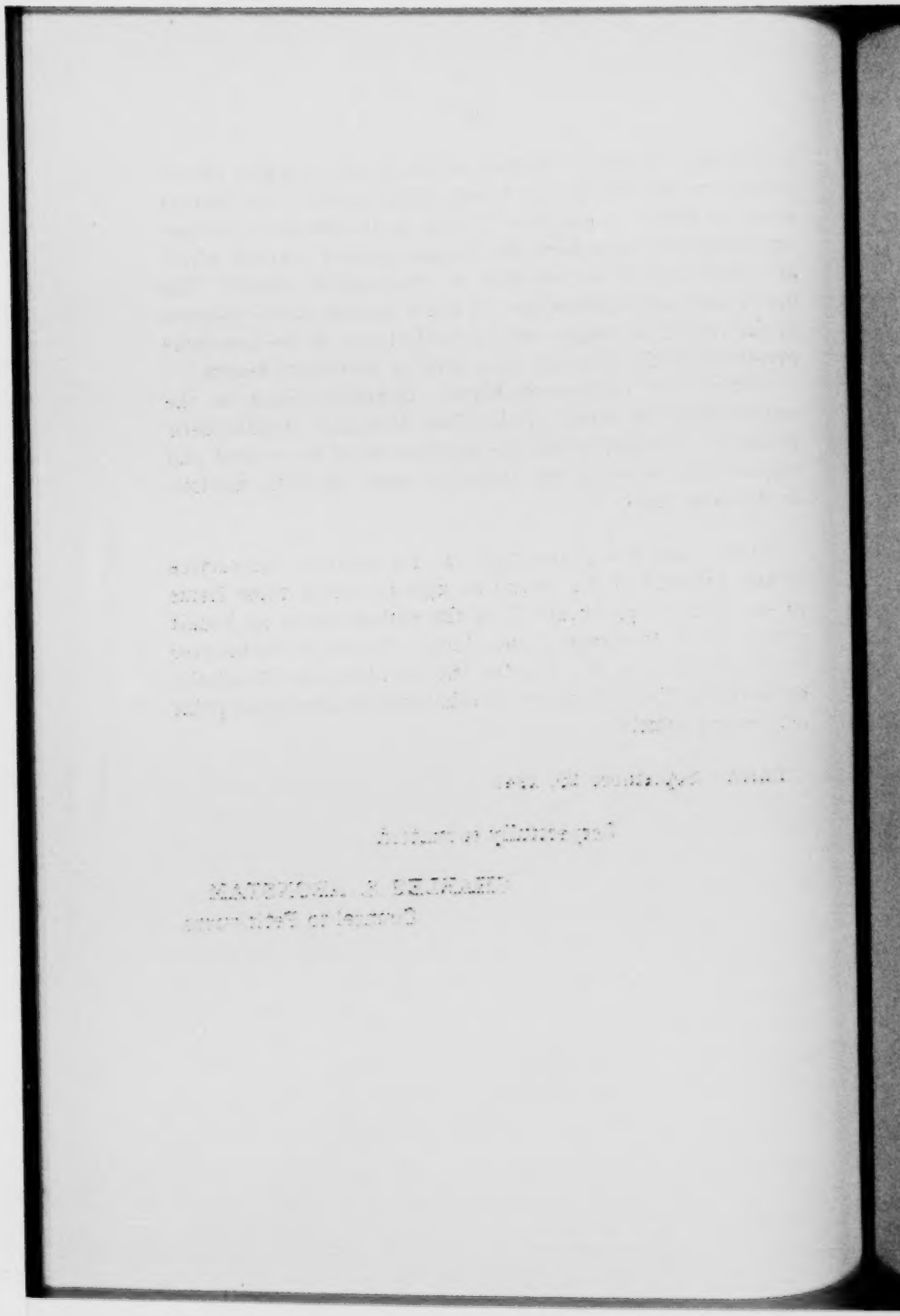

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 467.

WM. CARNEGIE EWEN, LEWIS L. CLARKE, M. D. ADAMS and GEORGE E. WILE, as members of a duly constituted Income Bondholders' Protective Committee,

Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY and DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, constituting the First Mortgage Bondholders' Protective Committee for The Peoria and Eastern Railway Company's First Consolidated Mortgage 4% Bonds due April 1, 1940,

Respondents.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI, AND ANSWER IN SUPPORT OF MOTION FOR DIMINUTION OF RECORD.

CHARLES S. ARONSTAM,
Counsel to Petitioners.

SUBJECT INDEX

	PAGE
Preliminary Statement	1
The Big Four—A Third Party	3
Inter-company Accounts	4
Right of Election of the Big Four to Renew Operating Agreement	5
The Big Four did not have the right to charge Respondent for monies expended for the maintenance and operation of its properties in excess of its net earnings	7
The Income Bondholders are adversely affected by the Plan of Adjustment and their written consents should have been secured	9
Answer to reply of Respondent The Peoria and Eastern Railway Company to petitioners' motion for diminution of record	10

TABLE OF CASES CITED

Gaswell Service, Inc. v. Sinclair Refining Co., 240 App. Div. (N. Y.) 240, aff'd 266 N. Y. 539	5
Getz v. Baltimore & Ohio R. R. Co., 309 U. S. 654, 697	2
Hoff v. Royal Metal Furniture Company, 117 App. Div. 884	5
Steelman v. Wichita Falls & S. R. Co., 390 U. S. 687, 84 L. Ed. 906	2
Western Transportation Co. v. Lansing, 49 N. Y. 499	5

TABLE OF STATUTES CITED

PA

Bankruptcy Act—Chapter XV:
Section 710 (Title II, U. S. C. A., §1210).....
Section 725 (Title II, U. S. C. A., §1225).....

TREATISE CITED

Williston, Contracts, Rev. Ed., Vol. 3, §623.....

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Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Preliminary Statement.

The brief presented on behalf of The Peoria and Eastern Railway Company, hereinafter referred to as the Respondent or the Peoria Company, presents an exclusively *laissez-faire* argument in opposition to the petition for a writ of

certiorari submitted on behalf of the Income Bondholders. It ignores entirely the rights and equities of the Income Bondholders who are adversely affected by the renewal of the Operating Agreement in the manner proposed in the Plan of Adjustment in that, by reason thereof, the Income Bondholders will be precluded from receiving any interest on their bonds for the next twenty years, the extended period of said Operating Agreement.

Although the brief is presented ostensibly on behalf of the Peoria Company, the arguments advanced are solely for the benefit of the New York Central and the Big Four. Therefore in this reply brief whenever reference is made to the Respondent it is intended to refer to the New York Central and the Big Four rather than to the Peoria Company *which is not independently represented in these proceedings.*

At the outset of its brief Respondent states that the United States Supreme Court has refused certiorari in the only other cases where review was sought under Chapter XV of the Bankruptcy Act: *Getz* v. *Baltimore & Ohio R. Co.,* 309 U. S. 654, 697; *Steelman* v. *Wichita Falls & S. R. Co.,* 309 U. S. 687, 84 L. Ed. 906.

The basic issue presented in both of the aforesaid cases was that bondholders who assented to the plan of adjustment prior to the filing of the petition for approval thereof occupied a class distinct from that of the non-assenters and therefore it was necessary to secure consents from the non-assenters as a class separate and apart from the class of assenters. None of the issues raised in the instant case were presented in the petitions in the aforesaid cases. Consequently the decisions in these cases are not applicable herein and can have no bearing on the merits of the petition for writ of certiorari in the instant case.

The Big Four—A Third Party.

The Respondent in its brief attempts to convey to this Court that, insofar as the Plan of Adjustment is concerned, the Big Four was a *disinterested* third party and the Peoria Company had to bargain with the Big Four to vote its stock in favor of the Plan, to extend the Operating Agreement, and to pay the Purchase Money Lien on the Springfield Division provided the Plan became effective.

Respondent glosses over the fact that the Peoria Company is a wholly controlled subsidiary of the Big Four, which company in turn is a wholly controlled subsidiary of the New York Central. The three companies have common officers, directors, counsel and operating executives. In truth and in fact the Big Four and the Peoria Company are nothing more than instrumentalities of the New York Central. The Plan of Adjustment was promulgated by the New York Central through its instrumentalities, the Big Four and the Peoria Company, and the evidence adduced at the hearings clearly shows that there was no one representing the Peoria Company who could object to the right of the Big Four to renew the Operating Agreement. There was no one representing the Peoria Company to scrutinize the fairness and equitableness of the terms and conditions of the renewal. There were in fact no negotiations conducted at arms' length as to any of the terms and provisions in the Plan of Adjustment in which the interests of the companies were in conflict.

The vice of the entire situation is in the fact that the officers and directors of the New York Central, the Big Four and the Peoria Company, who are one and the same, have attempted to serve two masters with conflicting interests.

Inter-company Accounts.

The explanation of the Respondent that the reductions of the Peoria Company's indebtedness to the Big Four from 1919 to 1933 "is made up for the most part of re-audits" is contrary to the record facts and lacks plausibility. In 1920 Mr. Wm. A. C. Ewen, as Chairman of an Income Bondholders' Protective Committee, succeeded in reducing the indebtedness of the Peoria Company to the Big Four from $324,286.02 to $24,912.65 (Exhibits V, W). Thereafter Mr. Ewen became a director and Vice-President of the Peoria Company representing the Income Bondholders, and, through his efforts, the Peoria Company succeeded in recovering $755,629.88 which the Big Four had charged against it erroneously (Exhibit X). Mr. Ewen's letter to the President of the New York Central (Exhibit Y) dated February 24, 1933, written while he was still Vice-President, completely refutes the specious contention of Respondent that these reductions were made in the ordinary course of business and clearly shows the dual and conflicting relationship existing between the companies. The following excerpts from Mr. Ewen's letter are pertinent to the inquiry herein:

> "This is an extraordinary situation—an anomaly—virtually a dual management, and was put into effect after an investigation by me of the affairs, in 1919, of the P. & E. that had resulted in the recovery of some $350,000 from the 'Big Four', mostly due to irregularities and partly due to the operation of the so-called Operating Contract of 1890. An iniquitous contract that had been imposed upon the newly created Peoria and Eastern * * * a contract that, among other things, was never submitted to the Minority Stockholders for approval and ratification. The 'Big Four' thru its President, the late Melville E. Ingalls, created a stock capitalization for the P. & E. of $10,000,000 * * * It (the Big Four) took $5,000,000 of the $10,000,000 stock without paying any cash consideration for it, and then it ac-

quired one share (par value $100) for cash that gave the 'Big Four' a majority of the stock to vote and control the P. & E. It elected all the directors —according to my best information and belief, dummies—who voted and by their action executed and put into effect the Operating Contract, that is placed the P. & E. in bondage. * * *

* * * * * * *

"From 1925 to 1932, I have from my own individual work and investigations * * * recovered and got credit for the P. & E. a sum aggregating $755,629.00. This is confirmed by the 'Big Four' and the P. & E. books."

Except for Mr. Ewen there never was a time when there was anyone to supervise the inter-company accounts or to negotiate with respect to the allocation of the various credits and charges between the companies.

Right of Election of the Big Four to Renew Operating Agreement.

Respondent does not cite one case in support of its contention that the Big Four had the right to renew the Operating Agreement for twenty years under the provision contained therein "for such further time thereafter as it may elect."

Respondent fails to advise this Court that recently the case of *Hoff* v. *Royal Metal Furniture Co.*, 117 App. Div. 884, was distinguished from *Western Transportation Co.* v. *Lansing*, 49 N. Y. 499, and the doctrine of the latter case reaffirmed in *Gaswell Service, Inc.* v. *Sinclair Refining Co.*, 240 App. Div. 240, aff'd 266 N. Y. 539, wherein the Court said:

> "We are of opinion, therefore, that defendant's continuance after the date of its leases was at will and terminable when the defendant vacated; and that there was such indefiniteness of term as to render the lease void for uncertainty. (*Western*

Transportation Co. v. *Lansing*, 49 N. Y. 499; Jones Landl. & Ten., §112, p. 137.) *The leases in Hoff* v. *Royal Metal Furniture Co.* (117 App. Div. 884) *and Burns* v. *City of New York* (213 N. Y. 516) *contain provisions for fixed, definite renewals, and thus presented covenants that were in no way indefinite*" (p. 241).

The other cases cited by Respondent have no application to the instant case. In these cases the Court had before it the construction of an option to renew a lease which contained the choice of several specified periods. In none of these cases was the period of renewal left uncertain and indefinite, with the lessee retaining the unlimited right to decide at a subsequent date the nature and extent of his performance. The fact that the Special Court was not able, as it stated in its opinion, to find any pertinent decisions in Illinois and Indiana, where the railroad is located, was no reason for it to disregard the law as enunciated in the cases cited in the brief of the Income Bondholders in the lower court and in the brief in support of their petition for writ of certiorari.

The argument advanced by Respondent that, assuming the expiration of the Operating Agreement at this time, the advances made by the New York Central and the Big Four would continue as a liability of the Peoria Company distorts the clear and unambiguous language in the Operating Agreement which provides that the Big Four "shall and will look only to such future net earnings of said lines of railroad operated by it * * * for reimbursement to it of any sums it may advance." Paragraphs Third and Seventh of the Operating Agreement clearly shows that it was the intention of the parties that advances were to be repaid only out of future earnings during the life of the contract (Exhibit 26). At the hearings before the Interstate Commerce Commission counsel for Respondent virtually conceded that, if the Operating Agreement is ended, the inter-company debts are extinguished. He stated: "In any event, it serves as, undoubtedly, an addi-

tional reason why we think that this arrangement should be continued for a further period of time, because in that respect it will offer the New York Central an opportunity, if the earnings permit, to retain repayment of all or portion of that indebtedness that might otherwise be doubtful." The Special Court recognized the soundness of the Income Bondholders' contention when it stated in its opinion: "It is true that by so doing the New York Central will be able to recoup for its past advances out of future income, a privilege which would have otherwise ended on April 1, 1940."

Nor can it be validly said that such a result is inequitable to the Big Four. The Big Four created this debt itself and agreed to recoup its advances only out of the net earnings of the Peoria Company created by its operations. To hold the Respondent liable for this debt after the expiration of the Operating Agreement would be a most inequitable result to the Income Bondholders who would be burdened with an obligation created by the parent company without let or hindrance on the part of the subsidiary company.

The Big Four did not have the right to charge Respondent for monies expended for the maintenance and operation of its properties in excess of its net earnings.

Respondent's contention that the Big Four had the right to charge the Peoria Company for monies expended for its maintenance and operations has no legal basis in fact and in law.

1. Under the provisions of the Operating Agreement the advances became extinguished with the termination of the Operating Agreement which expired by its terms on April 1, 1940.

2. Under the provisions of the Operating Agreement the Big Four undertook "at its own cost and expense"

to maintain and operate Respondent's properties and to hold the Respondent free and harmless from any liability therefor. The provisions of the Agreement entered into between the Reorganization Committee of the Ohio Company and the Big Four (Exhibit S) conclusively refutes Respondent's strained and self-interested interpretation of the Operating Agreement. The provisions of the Income Mortgage have no relevancy to the propriety of the Big Four charges as the rights and obligations of the Big Four are controlled entirely by the provisions of the Operating Agreement. The right of the Income Bondholders to the payment of interest is also controlled entirely by the provisions of the Operating Agreement during its existence and not by the provisions of the Income Mortgage.

3. The charges are of doubtful origin as is indicated by the letter of Mr. Wm. A. C. Ewen (Exhibit Y) and were created by the Big Four without any independent supervision by reason of its unrestricted control and domination of Respondent.

The contention of the Income Bondholders that under the Operating Agreement the Big Four cannot charge for monies expended to maintain the Peoria Company's properties in excess of the net earnings is in accord with the interpretation of the Agreement by the President of the Big Four to his Board of Directors three days after its execution (Exhibit O).

Williston on Contracts, Rev. Ed., Vol. 3, states as follows:

> "§623. The interpretation given by the parties themselves to the contract as shown by their acts will be adopted by the Court, and to this end not only the acts but the declarations of the parties may be considered."

Respondent dismisses the President's statement as "a mere informal generalization of the total obligation of the

Big Four." The President's interpretation of the Operating Agreement, that the Big Four had taken over the operation of Respondent's properties at a net rental of $412,200, precludes any hypothesis that there could be a deficit chargeable to the Peoria Company on account of maintenance and operating expenses.

The Income Bondholders are adversely affected by the Plan of Adjustment and their written consents should have been secured.

The Income Bondholders do not object to the distribution of the $5,000,000, the proceeds from the Purchase Money Lien, to prior lienors and do not contend that they are adversely affected thereby. The Income Bondholders contend that the renewal of the Operating Agreement in the manner proposed in the Plan of Adjustment adversely affects their interests for the reasons set forth under Point D of their brief in support of their petition for a writ of certiorari, and by reason thereof their written consents should have been secured in the manner provided in Sections 710 and 725 of Chapter XV. Respondent wholly fails to make any answer to this contention in its brief.

The writ of certiorari to the United States District Court for the Southern District of New York should be granted.

Dated: New York, New York, October 22, 1940.

Respectfully submitted,

CHARLES S. ARONSTAM,
Counsel to Petitioners.

CHARLES S. ARONSTAM,
ARCHIE S. KARP,
of Counsel.

Answer to reply of Respondent The Peoria and Eastern Railway Company to petitioners' motion for diminution of record.

Since the Respondent has made no objection to petitioners' motion for the printing of a joint record with the First Mortgage Bondholders' Protective Committee (No. 466), petitioners respectfully request that the answer of said Committee to the reply of The Peoria and Eastern Railway Company to the motion for the diminution of the record be deemed the answer of the petitioners herein.

Dated: New York, New York, October 22, 1940.

Respectfully submitted,

CHARLES S. ARONSTAM,
Counsel to Petitioners.